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FOREIGN EXCHANGE AND FINANCIAL LEAKAGES IN AFRICA

Executive summary

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1. The ECA secretariat organized a workshop in January 1983 and another one in February 1984 on the topic of financial resource leakages in Africa. Representatives of African research institutes and of international organizations participated in these workshops and/or in the preparation of commissioned studies on the subject. The Third session of the Joint Conference of African Planners, Statisticians and Demographers, which was held in March 1984 received a report on the ongoing study and put its strong recommendations and support for the study programme.

2. Several factors lend support to the emphasis being given to the study of leakages. A meeting of representatives of African research institutes convened by ECA in March 1982 identified "resource leakages" as a priority research area and one that falls within the purview of the research focus of the Lagos Plan of Action. The recent drought and famine conditions, the unfavourable effects of the global economic crisis and economic recession on the African economies, and the poor economic performance record of many member countries give added significance to the consideration of scarce resource use and management in Africa. Resource leakage is one form of the manifestations of poor economic management practice and a factor adversely affecting the level and rate of economic growth and development. A focus on this problem area and the development of appropriate policy measures are, therefore, timely, relevant and urgent considerations.

3. The study entitled "Foreign exchange and financial leakages in Africa" puts together in a suitable framework the various studies carried out on the subject under the auspices of ECA. Part 1 provides background information, and in part 2 attempt is made to deal with the issues of concept and methods. Resource leakages may be conceived as deviations from "optimum" levels of income or any other objective and may be measured as incomes or resources forgone. It may also be possible to use the framework of the balance-of-payments accounts to conceptualize and measure leakages. Thus the leakages in the commodity accounts, invisible accounts, unilateral transfer accounts, and in the long- and short-term capital accounts can be identified and be measured. So would illegal trade practices including smuggling which constitute major resource leakage mechanisms in Africa. In this study it is the framework provided by the balance-of-payments accounts that is mostly used for purposes of conceptualizing and measuring net resource outflows from Africa, though resource outflows as such should not be construed as leakages.

4. Furthermore leakages have as many forms as they have many sources. They could be trade related as in the above definition. But leakages can be policy induced (as when influenced by the investment and development strategy adopted) or they may result from poor economic management (as in the case of overloaded bureaucracy, corruption of public officials, and general economic inefficiency). Leakages may also be institutionally constrained (as when resulting from relationships with transnational corporations or from specific debt management practice). Financial resources can be leaked out through management and consultancy service overcharges or they could be indicated in the braindrain. All aspects of leakages may not be quantifiable and while some aspects of non-financial leakages are mentioned, the study focuses on the foreign exchange and financial leakages.

5. The attempt to measure the magnitude of financial leakages (see part 3) has not resulted in the estimation of all or total net resource outflows. Data on illegal trade cannot be obtained at regional levels and are often lacking even at country level studies. Many aspects of the leakages associated with the various balance-of-payments accounts, although measurable in theory, can only be estimated with wide margins of error in practice. While, therefore, the true magnitudes of financial leakages from Africa become guesswork, the values of net leakages from the current account of the balance of payments alone are estimated at $US5 to 6 billion per annum in recent years. This is a considerable sum of money given an average GDP of around $US310 billion (at constant 1980 prices) per annum for the whole region during the 1980-1984 period. Looked at in another way, leakages on the current account of the balance of payments are estimated at around 4 per cent of total foreign trade (i.e., exports plus imports) value for the region as a whole.

6. In view of their growing relative significance in recent years as sources of foreign exchange leakages in Africa, transnational corporations and debt management are given an expanded treatment in the study. The rate of inflow of foreign direct investment in Africa has been relatively low and growing slowly during the past decade. Most of these investments are in extractive industries and their limited developmental impact has led to frustrations and caused the introduction of diverse measures ranging from nationalization of investments to the institution of attractive investment codes with tax concessions and other guarantees. During the 1970-1980 period the total recorded inflow of foreign direct investments world wide is estimated at $225.4 billion. Africa's share of these has been a mere 4.1 per cent. It is also interesting to add that the rate of reinvestments (of investment earned incomes) has been the lowest for any major region. During the 1978-1980 period (for which data are available), earnings reinvested were only 9.7 per cent in Africa while for the developing countries as a group, the developed market economies and the world, the corresponding rates were 27, 30 and 29 per cent respectively. While the rates of inflow of foreign direct investment and the rate of reinvestment of investment incomes are the lowest in Africa in comparison to other regions of the world, the rate of outflow of payments on foreign direct investments have been the highest: 9.6 per cent of the recorded outflows of earned investment incomes of $194 billion world wide during the 1970-1980 period come from Africa. The ratio of payments outflow to inflow of foreign direct investments for the period 1970-1980 has been 201.4 per cent in Africa - the highest such ratio for any major region of the world. Transnational corporations leak out resources through a variety of channels, including overpricing of their technology and expert services, heavy importation of expensive raw material inputs, low pricing of their export outputs and through transfer pricing. While Africa must co-operate with multinational corporations in order to enhance its development effort, a lot needs to be done to ensure a fair sharing of the benefits from such association.

7. The debt situation in Africa has been getting worse in recent years. External total debt estimated at $57 billion in 1978 rose to $88 billion in 1982 at an average annual rate of growth of 11.4 per cent. Whereas in 1970 only 31 per cent of the African countries had a debt to GNP ratio in the range of 21 to 30 per cent, in 1982 the number of these countries rose to 80 per cent. Furthermore, with the worsening debt situation, an increasing number of countries

are seeking debt relief through multilateral renegotiations. At the same time the costs of borrowing have been constantly rising. Interest payments which averaged 5.6 per cent during 1973-1977 rose to 8.2 per cent during the 1978-1982 period. On the other hand, maturity (in years), grace periods and the grant element in loans are continually declining. The total debt service in Africa which was $5.5 billion in 1978 increased to $13.3 billion in 1982. As a ratio of GNP it rose from a low level of 1.6 per cent in 1970 to 3.9 per cent in 1982. Further, the debt service ratio which was 6 per cent in 1970 increased to the 14 per cent level in 1980. Thus the costs of borrowing have been increasing, resulting from changing compositions of loans (short-term loans as against long-term ones, for example) and due to the changes in the associated terms and conditions of borrowing. These developments have increased the rate of outflow of monetary resources from Africa through debt servicing.

8. The intensity of the resource leakage problem and the use of various leakage mechanisms are illustrated by some case studies (see part 4). The specific sources, mechanisms and magnitudes of these leakages vary from country to country, and a good knowledge of the specific experiences is required for the development of appropriate policy and strategy to control the problem. Thus the land-locked countries of Botswana, Lesotho and Swaziland appear to manifest a resource leakage problem emanating from their unique association with the Republic of South Africa. Various institutional arrangements are at work causing resource transfers to the Republic of South Africa through the complex workings of the labour, commodity and money markets. The resource leakage problems in Nigeria take the form principally of foreign currency leakages, and these are determined to a large extent by developments in the fields of economic management, policy and programmes pursued by the Nigerian Government. The case study from the Congo emphasizes resource leakages arising from import trade and from the system of education. It is argued that resources are drained out of the country through high expatriate pay, purchases of educational materials from abroad and through the scheme of paying expensively for the training of many Congolese abroad. At the same time, the cultural bias of the education system and its lack of emphasis on the development of "professionalism" are mentioned as indications of the low benefits derived from the system of education in the country. Another case study from Senegal attempts to show the way foreign exchanges are leaked out of the country through the system of monetary institutions and associations with the French banking system. The CFA is linked to the French Franc by an intricate web of agreements, working rules and procedures. The example from Zaire focuses on resource leakages through the importation of inappropriate technology. These examples highlight some specific forms of the leakage problem in Africa. With many additional examples to follow, it may be possible to get eventually a more complete and a more balanced picture of the problems and issues of resource leakages in Africa than at present.